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C O N F I D E N T I A L SECTION 01 OF 02 GUANGZHOU 000562

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TAGS: PFIN ECON EINV ETRD CH
SUBJECT: South China Bankers Calm in Face of U.S. Financial Storm

Classified By: Consul General Robert Goldberg; reasons 1.4 (d)

¶1. (SBU) Summary: The U.S. financial crisis will have little impact on China's financial sector, according to U.S. managers at two south China banks. They point out that the exposure of Chinese banks to "toxic" instruments that have been weakened by the crisis is very small. They are more concerned about what impact asset value changes in China's property market and the difficult business environment facing small and medium enterprises (SMEs) might have on their banks. Both gave Chinese regulators good marks for their response to the U.S. crisis, but cautioned that dealing with a weaker economic environment could be difficult for Chinese bankers, businessmen and officials, many of whom have no experience with anything but rapid economic growth. End Summary.

Predicting Little Direct Impact

¶2. (C) The U.S. managers at two south China banks believe that U.S. financial sector troubles will have little direct impact on China's financial sector or economy as a whole. Michael Zink, the President of Guangdong Development Bank (GDB), which is part owned by Citigroup, pointed out to us that Chinese financial institutions generally have very little exposure to "toxic" U.S. financial instruments that have been weakened by the crisis and the direct impact would be minimal. What exposure that exists has already been disclosed, he said.

¶3. (C) Frank Newman, the Chairman of Shenzhen Development Bank (SDB), which is part owned by private equity firm Newbridge Capital, emphasized that most challenges facing China's financial sector and broader economy have local roots. He said that SDB had no exposure to Lehman Brothers or Fannie Mae securities. However, he noted that "everyone was watching" the situation in the United States.

Concern about SMEs and Property

¶4. (C) Zink highlighted the property sector and SMEs as being a greater concern for local banks. For the property sector, he commented that it remains uncertain whether there is a bubble in the market. He also listed some of the difficulties facing small and medium enterprises, including rising wages, input prices, energy costs and transportation expenses. Zink pointed out that the financial situation in the United States would indirectly affect these firms by weakening export demand, but noted that most of their problems remained domestic ones.

¶5. (C) Newman (who served as Deputy U.S. Treasury Secretary 1994-95) emphasized concerns about the environment facing SMEs over potential problems in the property sector. Despite wide-spread reports that export-oriented SMEs in the Pearl River Delta have been closing in large numbers, especially Taiwan and Hong Kong owned firms, Newman said that there had been almost no failures among SDB's SME clients. However, he said demand for borrowing among these clients had weakened, which in many cases could be tied to lower export demand. Despite government easing of restrictions that limited lending to

SMEs, Newman said that SDB was having trouble finding good SME clients that want to borrow.

¶6. (C) The real estate market is a concern, according to Newman, but he doesn't believe it will become a problem for SDB. SDB has been very careful about its involvement in the real estate market. It offered credit primarily for owner-occupied properties as these tended to be good loans. Defaults were more common among loans to speculators buying more than one property, an area SDB had generally stayed away from. He also noted that with rates coming down, it would become easier for most borrowers to keep up with their payments since nearly all mortgages in China have a variable rate.

Good Marks for Local Regulators

¶7. (C) Zink asserted that Chinese regulators were "doing all the right things" in dealing with the potential effect of U.S. financial uncertainty. He told us that they had inquired repeatedly to GDB to find out more about its exposure to weakened assets, non-performing loan ratio, risk assessments and liquidity. Regulators had been focused in ensuring that banks were adequately capitalized. They also asked about exposure to the real estate market; Zink noted that they were trying to take on board the lesson from the U.S. situation by assessing the impact of a change in value in major asset classes.

¶8. (C) The regulators are "doing fine," according to Newman, by gathering information but not taking extreme measures. Like Zink, he noted that there had been repeated requests for reports on SDB's status, often with a close-of-business deadline. He also pointed out that although sudden, unannounced regulatory changes have been an ongoing problem in China's banking sector, he had not detected any

significant up-tick in this kind of regulatory change since the U.S. crisis emerged.

Lack of Experience with Hard Times

¶9. (C) Zink and Newman agreed that charting a course through a more challenging economic environment was difficult for Chinese banks, businessmen and officials. Zink pointed out that the current generation of managers had practically no experience with economic downturns. He marveled at the notion that many were concerned about levels of GDP growth of "only" 8 percent. Newman pointed out that the Chinese government was playing a difficult balancing act trying to maintain growth and keep inflation in check. He wondered how it would navigate the situation with current signs that oil and food prices may be coming down.

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